

STATE OF ILLINOIS



ILLINOIS COMMERCE COMMISSION

October 25, 1996

Re: 95-0641

Dear Sir/Madam:

Enclosed is a certified copy of the Order entered by this Commission.

Sincerely,

Donna M. Caton

Donna M. Caton
Chief Clerk

Enc.

10/28/96

ROE 10.48%
ROR 9.41%
CWS Effort 10/24/96
10/23/96

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Consumers Illinois Water Company :
:
Proposed general increase in water:
rates in the Woodhaven Lakes : 95-0641
District and proposed general :
increase in sewer rates in the :
Candlewick Lakes District. :

ORDER

By the Commission:

On December 1, 1995, Consumers Illinois Water Company ("Respondent", "CIWC" or the "Company") filed with the Illinois Commerce Commission (the "Commission") tariff sheets designated as First Revised Title Page for Ill. C.C. No. 22, and Second Revised Sheet No. 1, First Revised Sheet No. 2 and First Revised Sheet No. 5 of the Schedule of Rates for the Lee County Water District (hereinafter referred to as the "Woodhaven-Water District"); and First Revised Title Page for Ill. C.C. No. 43, and First Revised Sheet No. 1 and Seventh Revised Sheet No. 2 of the Schedule of Rates for the Boone County Sewer District (hereinafter referred to as the "Candlewick-Sewer District"). In the tariff sheets, CIWC proposed a general increase in water rates for its Woodhaven-Water District and a general increase in sewer rates for its Candlewick-Sewer District, to become effective January 15, 1996. On December 20, 1995, the Commission initiated this proceeding to consider the reasonableness of the proposed tariff sheets, and suspended the proposed general increase in rates to and including April 28, 1996. On April 10, 1996, the Commission resuspended the tariffs to and including October 28, 1996.

In accordance with 83 Ill. Adm. Code 255, notice of the filing was posted in Respondent's business offices and published in newspapers of general circulation in the areas affected by the filing. Notice of the proposed rate increase also was sent to each affected customer with the first billing after the rate filing in accordance with Section 9-201 of the Public Utilities Act (220 ILCS 5/9-201). Petitions to intervene filed by the Candlewick Lake Association, Inc. ("CWL") and Mr. Robert Giovanoni, a resident of Candlewick Lake, were granted by the Hearing Examiner.

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission this matter came on for hearing before a duly authorized Hearing Examiner at the Commission's offices in Chicago, Illinois. The Company and Illinois Commerce Commission Staff ("Staff") were represented by counsel. Pre-trial hearings were held on January 24, 1996 and April 10 and 24, 1996. Evidentiary hearings were conducted on June 12 and 27, 1996. At the conclusion of the hearing on June 27, 1996, the record was marked "Heard and Taken."

The Company presented the testimony of Mr. Dennis D. Conwell, Vice President and General Manager of the Company's Districts which provide service in Will, Boone and Knox counties; Mr. James Maurer, CIWC's Vice-President-Finance and Treasurer; Mr. Stephen Himmell, CIWC's Vice President-Engineering; and Dr. Charles F. Phillips Jr., a rate of return expert.

Staff presented the testimony of the following witnesses: Mr. Michael Luth; Mr. Garret Gorniak; Ms. Ingrid Walter; Mr. Jonathan Rohrer and Ms. Maria Slattery of the Finance and Auditing Departments, Public Utilities Division; Mr. Thomas Stack, Director of the Water/Sewer Program of the Office of Policy and Planning; and Mr. Gunnard Kluck of Planning and Operations.

Mr. Giovanoni also presented testimony. CWL appeared and participated in the hearings but did not sponsor any testimony or exhibits.

Initial Briefs were filed by the parties on July 19, 1996. On July 25, 1996, CIWC filed a Motion to Strike certain portions of the brief filed by Mr. Giovanoni on the grounds that it contained extra-record assertions and referred to materials which were not part of the record in this proceeding. The Hearing Examiner set a briefing schedule for the Motion to Strike. Following consideration of the arguments presented by the parties, the Hearing Examiner granted the Company's Motion to Strike in its entirety. The parties filed Reply Briefs on August 9, 1996.

A Hearing Examiner's Proposed Order was served on the parties. The Company, Staff and Mr. Giovanoni filed Exceptions and Replies to Exceptions to the Proposed Order. Those Exceptions are considered herein.

I. SERVICE AREA AND NATURE OF OPERATIONS CANDLEWICK AND WOODHAVEN DISTRICTS

A. The Candlewick District provides water and sewer service to the Candlewick Lake Development which is located approximately five miles north of Belvidere in Boone County. The Candlewick Lake Subdivision consists of approximately 2,400 lots, a campground, and a few commercial lots. Service is available to all lots and, as permanent homes are built, meters are installed for billing purposes. Currently, there are approximately 1,100 residences which are connected to, and take service from, the Candlewick water and sewer systems. Customers who own lots on which residences have not yet been built or connected to the sewer system are charged an availability charge.

B. The Woodhaven District provides water and sewer service to the Woodhaven Lake Development, which is located approximately two miles northwest of Sublette off Route 52 in Lee County. The Woodhaven Lake Development consists of approximately 6,150 camping lots and 38 commercial lots. Water service is available to all lots and sewer service is available to approximately 5,300 lots. None of the camping lots is metered since all are charged the availability rate. Meters are installed for the commercial lots.

II. TEST YEAR

Respondent presented an historical test year ending December 31, 1994, which was adjusted to show changes which occurred or which are reasonably certain to occur through September 30, 1996. The Commission concludes that the test year ending December 31, 1994, with adjustments for known and measurable changes, is appropriate for purposes of this proceeding.

III. OVERVIEW OF THE PROPOSED CANDLEWICK-SEWER AND WOODHAVEN-WATER RATE INCREASES

A. Candlewick-Sewer District

In its initial filing, the Company states that its last rate order was entered in 1982 in Docket 81-0011. CIWC maintains that since that time the levels of operating expenses and rate base in the District have increased significantly. The Company posits that the most significant factor affecting the need for an increase in revenues is its investment of approximately \$4.6 million in a new wastewater treatment plant ("WWTP"). CIWC maintains that the new plant is necessary to meet current and projected load and to comply with applicable environmental regulations. In this filing the Company proposed an increase in annual revenue for the District of \$879,675.

Staff proposed, and the Company accepted, a number of adjustments to the income statement and rate base for the District, as presented by the Company. Staff also accepted certain adjustments to its rate base and income statement exhibits which were proposed by CIWC. The Company adopted the 10.45% cost of common equity and 9.41% overall cost of capital recommended by Staff witness Walter. CIWC also accepted the cost allocation methodology and rate design proposed by Staff witness Stack in his Rebuttal Testimony and Exhibits.

As a result of these agreements, there are no contested issues between the Company and Staff. They agree that the Commission should approve the rates developed by Mr. Stack. Those rates are

designed in accordance with his cost-of-service study to produce an increase in annual revenues for the District of \$688,933. This increase is necessary to produce the Staff's revenue requirement.

Mr. Giovanoni and CWL objected to the proposed rate increase, stating that it would create an economic burden on current customers as well as a windfall for the Company. In the alternative, Mr. Giovanoni proposed adoption of a "phase-in" rate increase.

B. Woodhaven-Water District

The Company proposed a 10% across-the-board increase in water rates for the Woodhaven District which, based on the revenue analysis performed by Staff will produce an increase in annual revenues of \$46,048. The existing rates for the District became effective on January 1, 1991. The increase in rates on that date was intended solely to recover the costs associated with adding a new well. CIWC states that the last order in which the Commission approved rates designed to recover increased O&M expenses was issued on February 1, 1982 in Docket 82-0167. Respondent states that the test year level of expenses (in particular, the costs of power, chemicals and labor) for Woodhaven-Water have increased significantly.

The Company avers that the evidence shows that the Woodhaven revenue requirement exceeds the annual revenues produced by its proposed rates. CIWC, however, indicated that it had limited its proposed increase to 10% on an across-the-board basis in accordance with an agreement reached with the Woodhaven Lake Association prior to filing.

Staff proposed a number of adjustments to the District's income statement and rate base CIWC presented. The Company accepted Staff's proposed adjustments. The revenue requirement developed by Staff on the basis of those adjustments, however, also exceeds the annual revenues produced by the Company's proposed rates. Accordingly, Staff recommended that CIWC's proposed rates for Woodhaven-Water be approved as filed.

IV. RATE BASE

The Company presented evidence regarding the appropriate pro forma rate bases for the 1994 test year for the Candlewick-Sewer and Woodhaven-Water Districts, as adjusted to reflect plant additions to be placed in service through September 30, 1996.

A. Candlewick-Sewer District

For Candlewick-Sewer, Staff proposed adjustments with regard to the following items: materials and supplies ("M&S"); undocumented additions to plant-in-service; contributions-in-aid-of-construction ("CIAC"); accumulated amortization of CIAC; post-retirement benefits; capitalized interest; projected costs of the WWTP and other post-test-year plant additions; and cash working capital. Staff's recommended adjustments are summarized as follows:

1. Wastewater Treatment Plant

The rate base proposed by the Company reflected plant additions which will be placed in service through September 30, 1996. The Company states that the most significant of these plant additions is a WWTP with a projected total cost of \$4.6 million. The new WWTP, which began operating on a test basis in January 1996, is an activated sludge-type mechanical plant process with tertiary treatment consisting of chemical precipitations for phosphorous removal and filtration.

Staff witness Gorniak proposed to exclude amounts for the new WWTP that were listed by the Company in categories that included "Omissions and Contingencies", "uncollected WWTP costs", and "miscellaneous" due to their non-specific nature. As a result, the total cost of the WWTP reflected in Staff's proposed rate base is \$4,234,311. Staff states that the total amount expended on the WWTP through May 31, 1996, was \$4,401,419.

CIWC and Staff concur that the new WWTP is necessary to meet current demand, and projected demand during the immediate future. They further agree that it is necessary in order to comply with effluent standards and requirements mandated by the Illinois Environmental Protection Agency ("IEPA"). Respondent states that the Candlewick previous WWTP was built in 1972, and had a design capacity of 0.1 MGD, which corresponds to a population of approximately 1,000 people based on IEPA guidelines. Respondent states that since 1988, when CIWC acquired the Candlewick system, the total number of residences connected to the system has grown from 150 to 1,070 as of December 31, 1995, for an estimated total population of 3,745. As a result of this growth, the old WWTP experienced hydraulic overloading in recent years and, on certain dates, did not meet the limits for certain discharge parameters set forth in the plant's NPDES Permit. The Company further maintains that the new WWTP is imperative in order to serve the population that is projected to increase to 5,000 within three years.

Company witnesses Conwell and Himmell testified regarding CIWC's decisions with respect to the design and construction of the new WWTP. These determinations were made after extensive study and analysis of a number of alternatives. Respondent posits that this extensive analysis supports its conclusion that the new WWTP is the most cost effective, viable alternative for meeting demand at Candlewick and for complying with the IEPA-mandated effluent standards and requirements.

The Company stated that it initially proposed construction of a 5,000 PE lagoon in a site located outside Candlewick Lake. In 1993, however, CIWC's application for the special use permit necessary to build the lagoon was opposed by the CWL and landowners near the proposed site and was denied by the Boone County Zoning Board. While the Company was evaluating whether further legal action was appropriate, the IEPA indicated, in correspondence dated November 5, 1993, that it would not support the lagoon alternative. The IEPA also directed the Company to develop a plan for providing wastewater capacity of at least 8230 PE (as would be needed at total build-out of the District's 2,403 lots) by the year 1998. The IEPA further directed that such plan not reflect use of the existing WWTP beyond 1995.

Respondent stated that, after receiving the IEPA correspondence, it performed an extensive review of other options for adding wastewater treatment capacity in the District. Certain alternatives analyzed by the Company, including the construction of a 5,000 PE lagoon, were determined not to be viable for the reasons discussed above. Respondent stated that it identified two viable options, both of which involve the construction of a mechanical plant. One option involved a Sequencing Batch Reactor ("SBR") process and the other option was a conventional oxidation ditch style ("Orbal") mechanical plant. Based on a detailed evaluation of those two options, the Company concluded that the SBR process is the best and least-cost alternative. Respondent stated that an engineering report recommending construction of an SBR plant was submitted to the IEPA in February 1994 and was approved by the IEPA in August 1994. Following the IEPA's approval, CIWC initiated detailed plans for the construction of the SBR plant. In March 1995, the Company submitted to the IEPA its plans and a construction permit application for the new WWTP. The IEPA issued an NPDES discharge operations permit for the new WWTP on August 4, 1995 and a construction permit on August 17, 1995.

Both Staff and the Company assert that the evidence shows that CIWC employed prudent procedures to control the cost of the new WWTP, including evaluation of alternatives, competitive bidding to obtain major work and equipment, and the use of its own in-house own engineering staff for design and inspection. They posit that

the evidence also shows that Respondent has acted prudently with respect to its design and sizing of the new WWTP. Both parties concur that the new WWTP is designed to meet the sewer load requirements at Candlewick now and over the near term, and to satisfy all conditions of the IEPA NPDES permit. The design average capacity of the new plant is 0.5 MGD, equivalent to a capacity of 5,000 PE. As previously indicated, Candlewick presently has a connected sewer load approximately of 3,745 PE. This load is projected to exceed 5,000 PE by the year 1999 and to continue to grow thereafter as new homes are built in the Candlewick Development. Additionally, Respondent avers that the IEPA directed the Company to develop a plan to provide for at least 8,230 PE by 1998.

Moreover, in order to facilitate the future expansion of the plant capacity to meet projected demand and comply with the IEPA directive, the Company sized the SBR basins in the new WWTP for 10,000 PE and slightly enlarged certain other WWTP facilities. Mr. Himmell testified that this will enable the Company to increase the capacity of the WWTP to 10,000 PE in the future, by adding aeration equipment from the top of the SBR basins, while the units are in operation, and raising the decant water level, thereby minimizing the cost of future expansion. CIWC states that its decision to design the plant in this manner added approximately \$80,000 to the cost of the new WWTP. The effect of making this incremental \$80,000 investment currently will be to reduce the estimated final cost of increasing the overall plant capacity to 10,000 PE by approximately \$480,000 in current dollars.

Staff witness Kluck presented testimony discussing his review of the Company's decisions and actions regarding design and construction of the new WWTP. He testified that he had reviewed CIWC's design and construction plans regarding the new WWTP and had conducted an analysis of the alternatives the Company considered. Mr. Kluck concurred with Respondent regarding the viable alternatives for the new plant. Additionally, he stated that, of the two viable options, the SBR process was the best and least-cost alternative. He maintained that his conclusion was confirmed by a detailed analysis and evaluation of the present value of revenue requirements ("PVRR") for each option. Mr. Kluck stated further that the Company's analysis shows that its decision to size the basin for 10,000 PE at this time minimizes costs to ratepayers on a PVRR basis. For these reasons, he concluded that the new WWTP is "used and useful" and that the Company's investment in that plant is prudent.

Mr. Giovanoni, a resident of Candlewick, made certain arguments regarding the new WWTP. While he did not question the need for the new WWTP or the Company's decisions with regard to its

design and construction, he asserted that Respondent did not take steps to address the need for a new WWTP in a timely manner and that CIWC's "late action" increased the cost to provide adequate facilities for Candlewick customers. Mr. Giovanoni also proposed that costs of \$4,331 for certain work performed by KL Consultants at the Company's University Park District be excluded from the rate base proposed by the Company and Staff. Finally, he argued that CIWC has not met its obligation of providing service and facilities which are adequate, efficient, reliable and environmentally safe for the sewer plant customers in Candlewick since 1990. To support this allegation, Mr. Giovanoni asserted that "permit violations" at the old 1,000 PE WWTP caused damage to Candlewick Lake in 1994 and 1995.

In response to these allegations, CIWC argues that his position is unsupported. The Company avers that the evidence shows that it has, at all times since its acquisition of the District, acted diligently and prudently to address the need for additional wastewater treatment capacity. Moreover, Respondent contends that Mr. Giovanoni presented no evidence to support his assertion that the earlier construction of a new WWTP would have resulted in reduced costs to Candlewick's customers. Respondent maintains that, contrary to his assertions, the evidence shows that earlier construction would have resulted in the need for an earlier increase in rates. This would have resulted in an overall increase in costs to the customers.

The Commission finds Mr. Giovanoni's arguments to be without merit. The record contains no evidence to support his assertion that occasional violations of certain discharge parameters at the old WWTP caused damage to Candlewick Lake. We are of the opinion that the evidence presented by CIWC and Staff shows that the new plant is necessary to meet current and projected load and to comply with applicable environmental regulations and that the Company's investment in that plant is prudent. The Commission, therefore, concludes that, as a result of certain Staff adjustments accepted by CIWC, the total cost of the WWTP reflected in Staff's proposed rate base is \$4,234,311. Through May 31, 1996, however, the total amount actually expended was \$4,401,419, which exceeds the amount included in the rate base proposed by the Company and Staff by \$167,108, far more than the amount of the two invoices identified by Mr. Giovanoni. Accordingly, an adjustment to subtract the costs of those invoices from rate base is not supported by the evidence and we reject Mr. Giovanoni's proposal.

The Commission finds that the last rate order for Candlewick-Sewer was issued in Docket 81-0011. The levels of operating expenses and rate base in that District have increased significantly since then. We agree that the most significant

factor affecting the need for increased revenue in the District is CIWC's investment of approximately \$4.6 million in a new WWTP which began operating in 1996. We also find that the cost of power, chemicals, labor and other operation and maintenance ("O&M") expense also has increased significantly since the Company's last rate order.

Based on the evidence, the Commission finds that CIWC's decision to build the new WWTP was prudent and that all of its project costs were prudently incurred and represent an investment in property which is used and useful in providing service to Candlewick customers and should be approved.

2. Other Additions to Plant-in-Service

CIWC proposed to include \$222,100 in rate base post-test year, non-WWTP plant additions projected to be in service as of September 30, 1996, in the amount of \$222,100. Staff proposed an adjustment to reduce this amount by \$7,791. The Company accepted Staff's adjustment.

3. Accumulated Depreciation and Deferred Income Taxes

Mr. Gorniak proposed adjustments to plant which had the impact of reducing accumulated depreciation by \$2,795. In its rebuttal presentation, CIWC proposed to modify the adjustment based on a change in the depreciation rate and proposed a further adjustment to decrease the accumulated depreciation reserve by \$827. Staff further modified the Company adjustment by increasing accumulated depreciation \$5,109 because the Company used an inconsistent methodology when computing accumulated depreciation for 1996.

The plant adjustments necessitated a \$3,110 Staff adjustment to deferred taxes. Due to the changed depreciation rate, CIWC proposed a further increase in deferred taxes of \$36,959, which Staff accepted.

4. Undocumented Additions to Plant-in-Service

Staff witness Luth proposed a ~~\$2,486~~ rate base reduction to eliminate two invoices for legal services which were not available for Staff review upon request. Absent an invoice, it is impossible to determine the purpose of the legal services or whether the legal services should have been expensed in the year incurred, or capitalized for inclusion in the "Franchises & Consents" account as was done by the Company. The Company agreed to reduce the Candlewick Sewer "Franchises and Consents" account accordingly.

*Adjustment
made in
Oct. 1996*

5. Contributions-in-Aid-of-Construction ("CIAC")

*CIAC increased
made in
Dec. 1996*

Mr. Luth increased CIAC by \$77,343 after multiplying Candlewick's \$650 sewer connection fee by Staff witness Stack's projected growth in connected customers since CIWC's acquisition of the system. The number of customers at acquisition, was increased by the number of customers who had paid the connection fee prior to acquisition, but who had not yet been connected. Mr. Luth also noted that CIWC had improperly accounted for \$7,150 in CIAC in 1993, thus understating CIAC by that amount. Test year depreciation expense also will reflect this adjustment. The Company agreed to increase the Candlewick Sewer CIAC account by \$7,150.

6. Accumulated Amortization of CIAC

Mr. Luth increased the accumulated amortization of CIAC by \$21,734 to reflect the amount of amortization associated with the average annual increase in CIAC since the District's acquisition plus the amortization of the additional \$7,150 in CIAC that should have been recorded by the Company in 1993.

7. Materials and Supplies Inventory

Mr. Luth proposed a \$413 reduction of the materials and supplies ("M&S") inventory, based on the estimated corresponding level of accounts payable. A return on materials and supplies inventory should not be granted until shareholders have funded the inventory.

8. Cash Working Capital

Mr. Luth increased the requested level of cash working capital, based on the difference in the formulas used by the Company and Staff to estimate cash working capital, and a difference in O & M expenses resulting from Staff adjustments.

Both methods apply a 1/8th factor to a level of O & M. The Company's method, however, includes non-cash expenses such as bad debt and depreciation expense, and also rate case expense, which the Commission has specifically excluded from earning a return. The Staff method removes non-cash expenses and rate case expense from the amount to which the 1/8th factor is applied.

The two formulas also treat accrued real estate taxes differently. CIWC removed accrued real estate taxes from working capital determined after applying the 1/8th factor to O & M which included accrued real estate taxes. The Staff formula eliminates accrued real estate taxes from the O&M level to which the 1/8th

factor is applied. Since Illinois real estate taxes are paid in the year following incurrence of the tax liability, there is no corresponding cash working capital requirement.

9. Post-retirement Benefits

The Company had not funded post-retirement benefits and therefore they represent a source of cost-free capital. Mr. Gorniak proposed a \$935 rate base reduction based upon this premise.

10. Capitalized Interest

CIWC used its 1995 capitalized interest rate to develop a capitalized interest expense for 1996. Mr. Gorniak used the forecasted 1996 capitalized interest rate and applied it to the WWTP cost during 1996, reducing capitalized interest expense by \$48,189.

B. Woodhaven Water-District - Rate Base Adjustments

For Woodhaven-Water, Staff proposed adjustments with regard to the following items: M&S inventory; unrecorded pump retirement; and cash working capital; and post-retirement benefits fundings. As a result, Staff and the Company agree that the rate base proposed by Staff for Woodhaven-Water as set forth on Appendix C of this Order can be summarized as follows:

1. Pump Retirement

Mr. Luth reduced the Woodhaven-Water Plant-in-Service and Depreciation Reserve by \$18,890, and Depreciation Expense by \$378, to reflect the retirement of a pump still included in the Plant in Service. CIWC stated that the retirement was recorded in the Woodhaven Water accounts in the Company's general ledger after the filing of Mr. Luth's direct testimony.

2. Materials and Supplies

Mr. Luth proposed a \$789 reduction of the M&S inventory for the reasons discussed under Ma&S inventory in the Candlewick-Sewer section of this Order.

3. Cash Working Capital

Mr. Luth increased the requested level of cash working capital for the reasons discussed under Cash Working Capital in the Candlewick-Sewer section of this Order.

4. Postretirement Benefits

The Company had not funded post-retirement benefits. Mr. Gorniak proposed a corresponding \$646 adjustment to rate base.

C. Purchase Acquisition Adjustment

The Commission's Order in Docket 86-0554, which authorized the purchase of the Woodhaven District, stated that for book purposes the acquisition adjustment should be amortized over a ten-year period. However, the Commission did not determine any ratemaking treatment in its Order. Mr. Gorniak proposed that any amortization be made "below-the-line". Thus neither expenses or rate base are affected for rate case purposes. Implicitly, the Company is following his proposal. The Commission now prescribes this ratemaking treatment.

Based on the evidence, the Commission finds that the rate bases set forth in Appendices A and C, for the Candlewick Sewer and Woodhaven-Water Districts, respectively, are supported by the evidence, reasonable and should be approved.

V. OPERATING REVENUES, EXPENSES AND INCOME

A. Candlewick-Sewer District - Summary

Respondent presented evidence regarding its pro forma levels of operating revenues, expenses and income for the twelve months ended December 31, 1994, and as adjusted to reflect changes reasonably certain to occur through September 30, 1996.

Staff proposed adjustments with respect to the expense items addressed in the following section of this Order. CIWC made an adjustment to reflect a correction in the composite depreciation rate used by both the Company and Staff in developing the income statements for Candlewick-Sewer in their direct cases. Staff accepted the Company's adjustment in this regard. As a result, the operating income statement proposed by Staff in its Rebuttal Testimony includes depreciation expense correctly calculated on the basis of a composite depreciation rate of 2.84%, the approved depreciation rate for Candlewick-Sewer. The adjustments to Company's operating statements identified below represent the Staff's final expense adjustments.

B. Candlewick-Sewer District - Income Statement Adjustments**1. Revenues**

Staff witness Stack determined that the Company had made several errors in the its revenue calculations and presented exhibits which corrected those errors.

He concluded that the current Candlewick rates would produce \$553,139 which was \$35,546 more than the amount indicated by CIWC. At the Company's proposed rates, Mr. Stack found that \$1,500,751 would be produced, or \$103,484 more than the amount CIWC calculated.

The Commission concludes that the revenues at present and proposed rates set forth by Mr. Stack and agreed to by the Company should be utilized in this docket.

2. Personnel Services Expense

Staff proposed a \$3,621 adjustment to reduce the District's test year personnel services expenses. Staff considered the expenses to be primarily shareholder related, and/or non-utility in nature; and/or unrelated to CIWC customers or the CIWC service area. The Company accepted Staff's adjustment.

3. Sundry Expense

Staff proposed an adjustment of \$1,314 to Candlewick's Sundry test year expenses. Staff considered these expenses to be non-recurring or non-utility in nature. The Company accepted Staff's adjustment.

4. Depreciation Expense

Mr. Maurer originally used a 2.68% composite depreciation rate for the Candlewick-Sewer District, but in his Rebuttal Testimony, he corrected the rate to 2.84%. Mr. Stack testified that he had reviewed the Commission's Orders entered in Docket 81-0011 and concluded from a review of the Order on Rehearing and the Exhibits presented in that case that the Commission's approved depreciation rate for the District was 2.84% as Mr. Maurer stated. Accordingly, Mr. Stack recommended and the Commission agrees that a composite depreciation rate of 2.84% be used in this case.

Mr. Gorniak and Mr. Luth proposed adjustments which affected depreciable accounts. Mr. Gorniak proposed adjustments to the new WWTP, other additions to plant-in-service, and capitalized interest. Mr. Luth proposed an adjustment to CIAC. Since

depreciable plant was changed, net depreciation expense (depreciation on plant-in-service less depreciation on CIAC) must change also. Due to the Company's proposed change in depreciation rate from its initial filing, the Company proposed an adjustment to Staff's amount, which Staff subsequently accepted. This led to a \$2,978 reduction of depreciation expense from the Company's original filing of \$175,608, resulting in a total depreciation expense allowance of \$172,630.

5. Interest Synchronization

Mr. Luth increased State Income Tax by \$1,571 and Federal Income Tax by \$6,685 to account for the difference in the interest expense deduction between CIWC's and the Staff's proposed rate bases. Staff's interest synchronization adjustment matches income taxes associated with the interest expense supporting rate base.

6. Incentive Compensation

Staff Witness Slattery proposed a \$1,296 adjustment to remove the incentive compensation expense from the revenue requirement as an expense that should be borne by the shareholders rather than the ratepayers.

Ms. Slattery further testified that including incentive compensation in the test year is contrary to ratemaking theory because theoretically it would compensate executives for achieving savings that already should have been included in the test year. She posits that this adjustment is consistent with the Commission's Order in the contemporary CIWC case, Docket 95-0342 (June 26, 1996).

7. Salary and Wages

Staff Witness Slattery proposed an adjustment of \$21,508 to reduce salary and wages. The first component of her adjustment disallowed \$15,204 in pro forma payroll costs related to the new WWTP, because these costs were not documented and therefore, not "known and measurable" as defined by 83 Ill. Adm. Code 285.150(e) (Part 285.150). The second component, \$480, concerned payroll costs by which estimated 1996 salary increases exceeded actual 1996 salary increases or related to situations in which salary increases could not be verified. The third component related to a terminated employee who was not replaced. She excluded the employee's pro forma salary of \$5,824 from test year salary and wage expense.

8. Officers' Salary Allocation

Ms. Slattery proposed a \$19,851 allocation of officers' salaries from the Kankakee-Water District to the Candlewick-Sewer District. This adjustment was based upon an adjustment in Docket No. 95-0342 in which Staff proposed to allocate salaries from the Kankakee Water District to other Districts.

9. FICA Expense

As a corollary adjustment to salary and wages, Ms. Slattery proposed an adjustment to reduce FICA expense by \$226.

10. Rate Case Expense

Ms. Slattery proposed two adjustments to rate case expense, one that such expense be amortized over seven years instead of the three-year period which CIWC proposed. She opined there was no evidence that the District will be in for a rate case in another three years. Nor had the Company provided any support for that amortization period. The District was in for its last rate case in Docket 81-0011 using a 1980 historical test year. CIWC has currently filed this case with a 1994 historical test year leaving 14 years between rate cases. She recommended that a seven-year period be used in this case as a compromise between the three-year Company estimate and the fourteen year period reflecting Candlewick's recent history. Her proposal of a seven-year amortization period resulted in a reduction of \$53,143 to test-year rate case expense.

Ms. Slattery also testified that, in the rebuttal testimony phase, she would testify regarding the level of rate case expense since no details existed pertaining to this issue when her direct testimony was prepared. In her rebuttal testimony, she sponsored a final adjustment which reduced the District's rate case expense by another \$6,294.

11. Invested Capital Tax

Ms. Slattery proposed an adjustment to increase the level of invested capital tax by \$3,816. This adjustment incorporated the Company's filed Cost of Capital Summary. She testified that the Company's capital structure used to compute the invested capital tax was not supported by its filing. Further, she testified that the CIWC's capital structure numbers on its filed Cost of Capital Summary should be the same as those used to compute the level of invested capital tax. In Docket 95-0342, Staff had proposed a similar adjustment which the Commission accepted.

12. Federal and State Income Tax**a. Error Correction**

Ms. Slattery proposed an adjustment which resulted in an increase of \$3,876 to federal income taxes and an increase of \$881 to state income taxes due to the fact that the amortization of the plant acquisition adjustment had been deducted twice from the Company's income tax calculation.

b. Allocation of 1993 Federal Income Tax Credit

Ms. Slattery proposed a reduction of federal income taxes. Her review of Respondent's tax calculation on its 1994 annual report revealed that a total credit amount of \$26,183 had not been allocated to all of CIWC's Districts. Her adjustment of \$2,338 was proposed to reflect proper allocation of the credit to the District.

13. Real Estate Taxes**a. Allocation of Real Estate Taxes**

Ms. Slattery proposed an allocation to increase real estate taxes by \$958. This adjustment was necessary because of an allocation of real estate taxes was made in Docket 95-0342 which had the same test year. In that case, Staff proposed an adjustment to allocate the real estate taxes on the CIWC main office in Kankakee to the other Districts. Ms. Slattery's adjustment makes the appropriate allocation to the Candlewick Sewer District consistent with the adjustment in Docket 95-0342.

b. Pro Forma Increase in Real Estate Tax Expense

Ms. Slattery also proposed an adjustment to reduce-test year real estate tax expense by \$406 on the basis that the pro forma increase of \$406 is not known and measurable.

c. Real Estate Tax Error Correction

Ms. Slattery also proposed an adjustment to increase test-year real estate taxes by \$2,158 due to an error that CIWC made when preparing its filing.

14. Materials & Supplies Expense

Staff Witness Slattery proposed an adjustment to reduce M&S expense by \$1,500. She testified that the Company-proposed pro-forma test year increase of \$1,500 should be eliminated on the grounds that it is not known and measurable.

15. Contractual Services Expense

Staff Witness Slattery proposed a comparable adjustment to reduce contractual services expense by \$780. She testified that the \$780 is not known and measurable.

16. Miscellaneous Expense

Ms. Slattery proposed a third similar adjustment to reduce miscellaneous expense by \$1,200 because it is not known and measurable.

Based on the evidence of record in this proceeding, the Commission finds that the adjustments to operating revenues, expenses and utility operating income as proposed by Staff and accepted by the Company are supported by the evidence, are reasonable and should be adopted. Upon giving effect to these adjustments, the Commission concludes that the Company's operating income statement at the approved rates shown in Appendix B, reflects the increase in annual revenues for Candlewick-Sewer of \$688,933.

E. Woodhaven-Water District - Income Statement Adjustments

1. Revenues

Staff witness Stack testified regarding the revenues produced by the existing rates of the Woodhaven-Water District and by those CIWC proposed. He determined that the Company had made two mistakes its revenue calculations. Mr. Stack presented exhibits which corrected those errors.

Specifically, Mr. Stack determined that the current Woodhaven rates would produce \$466,822 which was \$34,423 less than the amount CIWC indicated. At the Company's proposed rates, Mr. Stack determined that \$512,870 would be produced, or \$38,500 less than the amount CIWC calculated.

The Commission concludes that the revenues as calculated by Mr. Stack and accepted by the Company are reasonable and should be approved.

2. Personnel Services Expense

Staff proposed and adjustment to reduce the District's test year level of Personnel Services Expenses by \$4,040. The Company accepted Staff's position that adjustments were necessary because certain expenditures were primarily shareholder related; and/or non-utility in nature; and/or unrelated to CIWC customers or the CIWC service area. The Company accepted Staff's adjustment.

3. Sundry Expense

Staff adjusted to Sundry Expenses by \$1,465 because they were either non-recurring or non-utility in nature. The adjustments were accepted in Mr. Maurer Rebuttal Testimony.

4. Depreciation Expense

Mr. Luth proposed an adjustment (pump retirement) which affected a depreciable account. Since depreciable plant was changed, an adjustment reducing depreciation expense by \$378 was made.

5. Interest Synchronization

Mr. Luth increased State Income Tax by \$36 and Federal Income Tax by \$160 to account for the effects on income taxes resulting from the difference in the interest expense deduction between CIWC and Staff's proposed rate base. As explained under Interest Synchronization in the Candlewick-Sewer section of this Order, Staff's adjustment matches income taxes associated with the interest expense supporting rate base.

6. Incentive Compensation

As she did for Candlewick, Ms. Slattery proposed an adjustment to remove the incentive compensation expense of \$3,407.

7. Nonrecurring Training Costs

Ms. Slattery proposed an adjustment to eliminate \$16,208 in nonrecurring training costs. Ms. Slattery testified that her review of the expense variation analysis revealed that in the test year, the Company incurred an abnormally high level of miscellaneous expense.

8. Officers' Salary Allocation

Ms. Slattery proposed a \$5,113 adjustment to allocate part of the officers' salaries from the Kankakee Water District to the Woodhaven Water District for the same reasons discussed in the Candlewick section of this Order.

9. FICA Expense

As a corollary adjustment to salary and wages, Ms. Slattery proposed a \$131 adjustment to FICA expense.

10. Rate Case Expense

Consistent with her adjustment in Candlewick, Ms. Slattery proposed two adjustments to rate case expense. Ms. Slattery testified that upon examination of the past history of Woodhaven-Water, no indication existed that the District will be in for a rate case in another three years. Staff maintains that the Company did not provide any support for the proposed three-year amortization period. She stated that current rates for Woodhaven-Water District were approved by this Commission in Docket 82-0167. The rates approved in that docket were based on a 1981 historical test year. She stated that the proposed rates in the instant case are based on a 1994 historical test year leaving 13 years between rate cases. Her proposal that a seven-year amortization period be used in this case as a compromise position between the three-year Company estimate and the thirteen-year period reflecting Woodhaven's recent history. Ms. Slattery's proposal of a seven-year amortization period resulted in a reduction of \$4,000 to test-year rate case expense.

Ms. Slattery also testified that in the rebuttal testimony phase, she would testify regarding the level of rate case expense since no details existed pertaining to this issue when her direct testimony was prepared. Pursuant to her review of the level of rate case expense, she sponsored a final adjustment which reduced the District's rate case expense by another \$474. This adjustment reflected the reduction in the level of rate case expense. The Company did not oppose her adjustment.

11. Health Insurance Premium

Ms. Slattery proposed an adjustment of \$3,905 to reduce the test-year health insurance premium expense.

12. Federal and State Income Tax

a. Error Correction

Ms. Slattery proposed an increase of \$3,415 to federal income taxes and an increase of \$777 to state income taxes due to the fact that the amortization of plant acquisition adjustment had been deducted twice from the Company's income tax calculation.

b. Allocation of 1993 Federal Income Tax Credit

Ms. Slattery's review of the Company's tax calculation on its 1994 annual report revealed that a credit amount of \$26,183 had not been allocated to all of the Company's Districts. She proposed reduction of \$602 to federal income taxes to reflect proper allocation of the credit to the District.

13. Allocation of Real Estate Taxes

Consistent with her recommendation in Candlewick, Ms. Slattery proposed an adjustment whereby real estate taxes were increased by \$247.

14. Outside Contractor Expense due to Pump Repair

Ms. Slattery proposed an adjustment to reduce pump repair expense by \$13,019, or the 90% of the amount paid to Layne Western to repair the Byron Jackson well pump. She proposed that this expense be amortized over ten years since the Company indicated that no repair to this pump has been needed since the District was acquired in 1987.

F. Electric Service Rates

The Company is currently taking electric service from Commonwealth Edison Company ("Edison") under Rate 6. Staff witness Stack recommended that the Company make a comparison of the cost of electric service for the Woodhaven-Water District's operations under Edison's Rates 6 and 24 to determine if some or all of the electric accounts should be switched to Rate 24. Mr. Maurer testified that the Company has requested Edison on numerous occasions to provide information related to the effect of Rate 24 but that, to date, Edison has not provided the requested information. As a result, the Company has been unable to make a comparison of the cost of electric service for its operations under Rates 6 and 24.

Consistent with Mr. Stack's recommendation, Mr. Maurer testified that Respondent will continue to attempt to obtain the information from Edison necessary to permit it to make a comparison of the cost of electric service under Rates 6 and 24 and stated that, to the extent such a comparison shows that the cost of electric service at a particular location would be less under Rate 24 than it is under Rate 6, the Company will move to Rate 24. Mr. Stack testified that any savings that might reasonably be expected to result from switching to Rate 24 in the Woodhaven-Water District would be less than the difference between Staff's revenue requirement and the revenues produced by CIWC's proposed Woodhaven-Water rates and, therefore, would not impact Staff's recommendation that the rates proposed by the Company for the Woodhaven-Water District be approved as filed. Accordingly, there is no issue to be resolved by the Commission with respect to electric service rates.

Based on the evidence, the Commission finds that adjustments to operating revenues, expenses and utility operating income proposed by Staff and accepted by the Company are supported by the evidence, are reasonable, and should be approved.

VI. CAPITAL STRUCTURE AND COST OF CAPITAL

Evidence concerning the Company's capital structure and cost rates of capital was submitted in this proceeding on behalf of the Company by Dr. Charles Phillips, the Robert G. Brown Professor of Economics at Washington and Lee University, and by Mr. Maurer. Staff presented the testimony of Ingrid Walter, a Financial Analyst in the Finance Department of the Commission's Public Utilities Division. In her testimony, Ms. Walter adopted the test-year capital structure and cost rates for preferred equity and long-term debt proposed by Mr. Maurer in his Direct Testimony. In his Rebuttal Testimony, Mr. Maurer indicated the Company's acceptance of Ms. Walter's proposed cost rates for short-term debt and common equity.

Dr. Phillips presented evidence regarding the cost of common equity on behalf of the Company. He employed a market-determined approach, represented by the Discounted Cash Flow ("DCF") model, the risk premium method and the Capital Asset Pricing Model ("CAPM"). Dr. Phillips used two variants of the DCF formula: (i) a "traditional" DCF model, which holds that the cost of equity is equal to the sum of the expected dividend/market ratio (i.e., yield) and (ii) a "modified" DCF analysis which substitutes book value for market price. Due to the fact that CIWC's stock is not publicly traded, Dr. Phillips stated that he performed his DCF analyses for two proxy groups: a group of three operating water utilities and five water utility holding companies. In applying the "traditional" DCF model, he calculated dividend yields based

on market prices for two time periods: (a) the average spot price for the two months ended October 31, 1995 and (b) the price on November 23, 1995. Dr. Phillips adjusted the dividend yield component of the DCF analysis to reflect flotation costs incurred by the sample companies. He concluded that, for the operating water utilities, the common equity cost range utilizing the traditional DCF approach was 10.26% to 10.39%. For the water utility holding companies, he opined the range was 9.60% to 9.82%.

Dr. Phillips explained that when the market price of stocks used to develop a traditional DCF cost estimate is greater than book value, application of an unadjusted DCF result to the amount of book common equity which supports rate base will not produce sufficient revenue to cover the utility's market cost of common equity. At present, the market price of utility stocks utilities in his comparable sample is substantially in excess of book value. In light of the problem with use of the traditional DCF approach in present market conditions, Dr. Phillips considered the results of a modified DCF methodology in which the book value of stock is substituted for the market price in the DCF formula. All of the other inputs are the same as those used in the traditional DCF methodology. The modified DCF common equity cost estimates shown in Dr. Phillips' Rebuttal Testimony were 13.30% for the operating water utilities and 12.15% for the water utility holding companies.

Dr. Phillips also calculated estimates of the cost of common equity using two risk premium approaches and a CAPM approach. The first risk premium approach, which is based on a study of the utility risk premium over the yield on long-term Treasury bonds ("T-bonds"), produced a cost of common equity estimate in the range of 11.14 to 13.14 percent. The second approach, which is based upon a study of the utility stock risk premium over the average yield on A-rated corporate bonds, produced a cost of equity range of 10.48% to 11.48%. Dr. Phillips' CAPM analysis resulted in a cost of common equity estimate of 10.99%.

Based on the results of his analyses, as described above, Dr. Phillips concluded that CIWC's cost of common equity lies in a range of 11.28% to 11.37%. The lower end of the range is the mid-point of the risk premium and CAPM estimates, while the upper end of the range is the mid-point of the DCF cost of equity estimates.

He also took into consideration the unique risks faced by the water industry in general, and CIWC in particular, in arriving at his common equity cost recommendation. Dr. Phillips maintained that the entire water industry is faced with large expenditure requirements driven by more stringent state and federal environmental regulations, the need to rebuild aging infrastructure and by diminished water supply. He testified that CIWC confronts

all of the risks summarized above for the water industry. He stated that he also took into account CIWC's specific risks. In particular, he noted that the Candlewick-Sewer operation is a relatively high risk venture because of the relatively large amount of required capital investment associated with the new WWTP compared to its relatively small customer base. Based on his entire analysis, and taking into account the risks discussed above, Dr. Phillips concluded that CIWC's cost of common equity is 11.35%.

Ms. Walter testified that she performed DCF and CAPM analyses for a group of public utilities which she deemed to be closest in risk to CIWC. In selecting her sample, she considered all market-traded water, electric, and natural gas utilities for which data was available in the S&P's Utility Compustat data tapes. From those utilities, she selected seven utilities with total risk closest to the risk of CIWC, as determined by applying a "sum of the distance" methodology to five "principal components" of financial and operating risk.

Using a quarterly version of the DCF model, Ms. Walter stated that she developed dividend yields on the basis of closing market prices on March 21, 1996 and estimates of the next four expected quarterly dividends for each firm in the comparable sample. To estimate investor-expected growth rates, she examined analysts' projected growth rates in the February 15, 1996 edition of Institutional Brokers Estimate System ("IBES") and the March 11, 1996 edition of Zacks Investment Research ("Zacks"). Ms. Walter's DCF analysis produced an estimate of the cost of common equity for her comparable sample in the range of 10.09% to 10.46%.

Ms. Walter stated that she also analyzed the cost of common equity using the CAPM approach. As an estimate of the risk-free rate of return for the period during which rates will be set in this case, she used the interest rate (5.33%) implied by the prices of U.S. Treasury Bill ("T-bill") Futures Contracts, as traded on the International Monetary Market, for September 1996. She estimated the market risk premium by subtracting her 5.33% estimate of the risk-free rate from the expected return on the market portfolio of 14.17%, which she calculated by conducting a DCF analysis for the firms that comprise the S&P Composite Index. The resulting market risk premium was 8.84% over the T-bill yield. She determined CIWC's firm-specific risk premium using "beta," a coefficient which measures the sensitivity of a firm's stock price to fluctuations in the market as a whole. She used betas published in the March 15, 1996 Value Line Investment Survey. She also developed beta estimates by applying the Merrill Lynch beta calculation method to data contained in the S&P's Utility Compustat data tapes. Using this information, Ms. Walter calculated an average beta for the comparable sample of 0.60. Utilizing this

information, along with the estimates of the risk-free rate and market risk premium, Ms. Walter estimated that the CAPM cost of common equity for her comparable sample is 10.63%.

Ms. Walter further testified that a thorough analysis of cost of common equity requires both proper application of financial models and the analyst's informed judgment. In applying her judgment to the results of her DCF and CAPM analyses, she considered the observable market required rate of return of 7.58% on A-rated utility long-term debt, her estimated market return of 14.17%, and the inflation expectations incorporated in T-bill and T-bond yields. Based upon her entire analysis, it was her conclusion that the cost of common equity for CIWC ranges from 10.30% (the midpoint of her DCF range) to 10.60% (her CAPM cost estimate rounded to the nearest ten basis points). Ms. Walter's recommended allowed rate of return on common equity was 10.45%, the midpoint of her recommended range.

Giving effect to her proposed common equity cost recommendation and the proposed capital structure, Ms. Walter determined that the Company's overall cost of capital ranges from 9.34% to 9.47%, with a recommended midpoint of 9.41%, as presented in ICC Staff Exhibit 4.00, Schedule 18, and as shown below:

<u>Capital Component</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Short-Term Debt	6.80%	6.97%	0.47%
Long-Term Debt	47.94	8.82	4.23
Preferred Stock	0.54	5.52	0.03
Common Equity	<u>44.72</u>	10.30-10.60	<u>4.61-4.74</u>
Total	100.00%		9.34%-9.47%

In his Rebuttal Testimony, Mr. Maurer indicated that the Company accepts Staff's proposed common equity cost rate of 10.45% and resulting 9.41% overall cost of capital. We accept those rates.

VII. COST OF SERVICE AND RATE DESIGN

A. Candlewick-Sewer District

The current sewer rate for Candlewick consists of a \$27 per month flat rate for connected residential and commercial customers and an \$11.27 per month availability charge billed to each unconnected lot in the Candlewick Lake Subdivision. The Company

and Staff have agreed that the revenue requirement should be allocated between connected and availability customers in accordance with a cost-of-service study presented by Staff witness Stack.

In his study, Mr. Stack first allocated all plant items between availability and connected customers. The resulting overall percentage allocation of plant items was used to allocate plant and investment-related expenses. He then reviewed each general expense account and functionalized those expenses to distribution, treatment, billing and other. Based on the appropriate allocators, he spread the functionalized costs to connected and availability customers and added to this the allocation of capital-related expenses. In allocating the new WWTP, Mr. Stack first separated the incremental costs incurred to facilitate future expansion of the plant capacity to 10,000 PE and assigned the corresponding amount of \$77,000 entirely to availability customers. Of the balance of the WWTP costs assigned, 75.5% was assigned to connected customers and 24.5% was assigned to availability customers on the basis of the ratio of capacity currently used by existing connected customers to the plant's rated capacity. Based on the evidence, the Commission finds that Mr. Stack's cost-of-service methodology is reasonable and should be approved.

Based on the results of his cost-of-service study, Mr. Stack developed a proposed monthly rate of \$64.93 for connected residential and commercial customers and a monthly availability charge of \$21.05.

B. * Phase-In Rate

Mr. Giovanoni maintained that Staff's calculation of its recommended revenue requirement for Candlewick District does not reflect sewer charge revenues and sewer connection fees resulting from customer growth for periods subsequent to September 30, 1996. He asserted that those probable revenue flows support the adoption of a phase-in rate. As an alternative to a "phase-in," Mr. Giovanoni argued that the Commission should perform an annual review of actual sewer revenues as new homes are built.

In response to these assertions, Staff and the Company argue that the inclusion of revenue expense items for periods subsequent to September 30, 1996, is prohibited by the Commission's test-year rule. They aver that a historical test year, such as that used in this case, can be adjusted for changes reasonably certain to occur within twelve months of the time that rates are filed. The Company furthermore argues that it would be inappropriate and inconsistent

with Commission policy to consider potential changes in revenue related to customer growth without consideration of future changes in operating expenses and rate base.

The Commission finds the arguments advanced by Staff and the Company convincing. In accordance with Commission practice and proper rate-making policy, all items must be adjusted through the same date. In this instance, Staff and the Company properly reflected appropriate adjustments to all items through September 30, 1996. Consistent with Commission rules and practice we conclude that revenue related to customer growth for future periods cannot be reflected in the test year for this proceeding. Business and Professional People for the Public Interest v. Illinois Commerce Commission, 136 Ill. 2d 192, 219 (1989). For these reasons, the Commission rejects Mr. Giovanoni's argument.

The Commission furthermore rejects Mr. Giovanoni's suggestion that the Commission should consider revenues resulting from the future addition of new connected customers in setting rates in this case as inappropriate. We conclude that this "alternative" should also be rejected. The Commission finds that changes in all elements of the revenue requirement must be considered together. Accordingly, Mr. Giovanoni's proposal would require an annual rate case filing. We find that such an approach would be unreasonable, burdensome and unduly expensive.

Based on the evidence, the Commission finds that the rates proposed by the Company and Staff, will produce the annual revenue requirement and operating income approved in this Order, are supported by the evidence, reasonable and should be approved.

C. Woodhaven-Water District

The water rates in the Woodhaven District consist of a \$5.75 per month flat rate for each campsite (lot) and a \$2.50 per 1,000 gallons of water usage, plus a customer charge based on the size of the meter, for commercial customers. As previously discussed, the Company proposed to limit its proposed increase for Woodhaven-Water to 10% and filed for an across-the-board increase of 10% to all rates for service. Specifically, CIWC proposed that the campsite rate be raised to \$6.32 and that the usage rate be raised to \$2.75 per 1,000 gallons. All customer charges (which vary by meter size) also were increased by 10%.

The Commission finds that the evidence shows that those rates will produce annual revenues of less than the Company's revenue requirement. Mr. Stack recommended that Respondent's proposed rates for Woodhaven-Water be approved as filed.

VIII. FINDINGS AND CONCLUSIONS

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Consumers Illinois Water Company is in the business of furnishing water and sewer service to the public in the State of Illinois and is a public utility as defined in The Public Utilities Act;
- (2) the Commission has jurisdiction of the Company and of the subject matter herein;
- (3) on December 1, 1995, the Company filed revised tariff sheets in which it proposed a general increase in water rates for the Woodhaven-Water District and a general increase in sewer rates for the Candlewick-Sewer District;
- (4) in compliance with the law and the rules and regulations of this Commission, notice of the proposed increases was published by the Company in newspapers of general circulation in the service areas of the Company's Woodhaven-Water and Candlewick-Sewer Districts and posted in its offices, and a notice and description of the rate filing was included in the first bill mailed to each of the Company's customers after the rate filing; due notice of hearings in this proceeding was given to parties of interest by the Office of the Chief Clerk of the Commission;
- (5) on December 20, 1995, the Commission entered an order suspending the effectiveness of the proposed tariff sheets to and including April 28, 1996; thereafter, the Commission resuspended the tariff sheets to and including October 28, 1996;
- (6) the recitals of fact and the conclusions reached in the prefatory portion of this Order are supported by the evidence and are hereby adopted as findings of fact;
- (7) for the adjusted Test Year ended December 31, 1994, and, for purposes of this proceeding, the Company's original cost rate base for ratemaking purposes for the Candlewick-Sewer District is \$5,408,949 and for the Woodhaven-Water District is \$1,689,265; these amounts are found to constitute the value of the Company's property for purposes of this proceeding;

- (8) for the purposes of establishing rates in this proceeding, a fair and reasonable return on the original cost rate bases for the Candlewick-Sewer and Woodhaven-Water Districts is 9.41%, this rate of return reflects a fair and reasonable return on common equity of 10.45% rate of return on the Company's common equity capital; rates for the Candlewick-Sewer District should be set to allow the Company an opportunity to earn that rate of return on that district's original cost rate base, as determined herein; in the case of Woodhaven-Water, the rates filed by the Company (and approved herein) produce annual revenues which result in a rate of return on rate base of less than 9.41%;
- (9) the Company's present rates in the Candlewick-Sewer and Woodhaven-Water Districts are insufficient to generate the operating income necessary to permit the Company to earn a fair and reasonable rate of return and those rates should be permanently cancelled and annulled in accordance with this Order;
- (10) the tariff sheets initially filed by the Company for the Candlewick-Sewer District in this proceeding contain rates which are not, in certain respects, just and reasonable; said tariff sheets should, therefore, be permanently cancelled and annulled in accordance with this Order;
- (11) the evidence demonstrates that an increase in annual revenues of approximately \$688,933 and an increase in net operating income of approximately \$421,608 are necessary to produce a rate of return on rate base of 9.41% in the Candlewick-Sewer District;
- (12) the evidence demonstrates that an increase in annual revenues of approximately \$81,484 and an increase in net operating income of \$46,035 would be necessary to produce a rate of return on rate base of 9.41% in the Woodhaven-Water District; the rates proposed by the Company for Woodhaven-Water produce an increase in annual revenues of approximately \$46,048 and an increase in net operating income of approximately \$26,015;
- (13) the evidence demonstrates that the rate design and class revenue allocations discussed and described in the prefatory portion of this Order, are just and reasonable and should be approved;

- (14) the tariff sheets initially filed by the Company for the Woodhaven-Water District in this proceeding contain rates which are just and reasonable;
- (15) the Company is authorized to file new tariffs for the Candlewick-Sewer District, to become effective for all service rendered on or after the day of said filing;
- (16) all motions and objections made in this proceeding which remain undisposed of should be considered disposed of in a manner consistent with the ultimate conclusions contained herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the Suspension Order entered on December 20, 1995, and the Resuspension Order entered on April 10, 1996, are hereby vacated and set aside.

IT IS FURTHER ORDERED that the tariff sheets containing rate schedules proposing a general increase in rates for the Woodhaven-Water District filed by Consumers Illinois Water Company on December 1, 1995, shall become effective immediately.

IT IS FURTHER ORDERED that the tariff sheets containing rate schedules proposing a general increase in rates for the Candlewick-Sewer District filed by Consumers Illinois Water Company on December 1, 1995, are hereby permanently cancelled and annulled.

IT IS FURTHER ORDERED that Consumers Illinois Water Company is hereby authorized and directed to file new tariff sheets for the Candlewick-Sewer District placing into effect rates and charges in accordance with the findings of this Order, said tariff sheets to be effective immediately upon filing.

IT IS FURTHER ORDERED that upon the effective date of the tariff sheets approved pursuant to this Order, the presently effective tariff sheets of Consumers Illinois Water Company which are replaced thereby are hereby permanently cancelled and annulled.

IT IS FURTHER ORDERED that any objections and motions that remain undisposed of be, and the same are hereby, disposed of consistently with the ultimate conclusions herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 23rd day of October, 1996.

(SIGNED) DAN MILLER

Chairman

(S E A L)

Consumers Illinois Water Company - Candlewick Sewer District
Rate Base
For the Test Year Ending December 31, 1994

Line No	Description	Company Rebuttal Pro Forma	HEPO Adjustments (Sch.2)	HEPO Pro Forma (Col B+C)
-----	-----	-----	-----	-----
(A)	(B)	(C)	(D)	
1	Plant in Service	\$7,106,203	\$0	\$7,106,203
2	Depreciation Reserve	(1,077,905)	(5,109)	(1,083,014)
3		-----	-----	-----
4	Net Plant	6,028,298	(5,109)	6,023,189
5				
6	Additions to Rate Base:			
7				
8	Materials and Supplies	8,369	0	8,369
9	Working Capital	40,074	(163)	39,912
10	Accum. Amortization of Contrib.			
11	in Aid of Construction	247,723	2,645	250,368
12				
13				
14				
15				
16	Deductions from Rate Base:			
17				
18	Contributions in Aid			
19	of Construction	(972,464)	0	(972,464)
20	SFAS 109 Regulatory Liability	(2,000)	0	(2,000)
21	Deferred Income Taxes	80,923	0	80,923
22	Unamortized Plant Acquisition			
23	Adjustment	(18,413)	0	(18,413)
24	Post-retirement Benefits Funding	(935)	0	(935)
25				
26				
27		-----	-----	-----
28				
29	HEPO Rate Base	\$5,411,575	(\$2,627)	\$5,408,949
		-----	-----	-----

Consumers Illinois Water Company - Candlewick Sewer District
Adjustments to Rate Base
For the Test Year Ending December 31, 1994

Line No	Description	Accumulated Amortization of CIAC (Staff EX 1.00R, Sch.7R)	Working Capital (Staff EX 1.00R, Sch.8R)	Pro forma Reserve for Accumulated Depreciation (Staff EX 2.00R, Sch.1R)	(E)	(F)	(G)	(H)	(I)	(J)	Total Rate Base Adjust- ments (K)
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
1	Plant in Service										\$0
2	Depreciation Reserve			(5,109)							(5,109)
3											
4	Net Plant	0	0	(5,109)	0	0	0	0	0	0	(5,109)
5											
6	Additions to Rate Base:										
7											0
8	Materials and Supplies										0
9	Working Capital		(163)								(163)
10	Accum. Amortization of Contrib.										
11	in Aid of Construction	2,645									2,645
12											
13											
14											
15											
16	Deductions from Rate Base:										
17											
18	Contributions in Aid										0
19	of Construction										0
20	SFAS 109 Regulatory Liability										0
21	Deferred Income Taxes										0
22	Unamortized Plant Acquisition										0
23	Adjustment										
24	Post-retirement Benefits Funding										0
25											0
26											
27											
28											
29	HEPO Rate Base	\$2,645	(\$163)	(\$5,109)	\$0	\$0	\$0	\$0	\$0	\$0	(\$2,627)

Consumers Illinois Water Company - Candlewick Sewer District
Adjustments to Operating Income
For the Test Year Ending December 31, 1994

Line No	Description	Interest Synchron- ization (Staff EX 1.00R, Sch.6R)	Incentive Compensation (Staff EX 3.00R, Sch.1R)	Rate Case Expenses (Staff EX 3.00R, Sch.2R)	(E)	(F)	(G)	(H)	(I)	(J)	Total Operating Statement Adjustments (K)
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
1	Tariffed Revenues										\$0
2	Other Revenues										0
3											
4	Total Operating Revenue	0	0	0	0	0	0	0	0	0	0
5											
6	Salaries and Wages		(1,296)								(1,296)
7	Employee Pensions and Benefits										0
8	Purchased Power										0
9	Chemicals										0
10	Materials and Supplies										0
11	Other Oper. and Maintenance Exp.										0
12	Regulatory Commission Expense			(6,294)							(6,294)
13	Bad Debts										0
14	Depreciation Expense										0
15	Taxes other than Income										0
16											
17											
18	Total Operating Expense										
19	Before Income Taxes	0	(1,296)	(6,294)	0	0	0	0	0	0	(7,590)
20											
21	State Income Tax	0	93	452	0	0	0	0	0	0	545
22	Federal Income Tax	0	409	1,986	0	0	0	0	0	0	2,395
23	Deferred Taxes and ITCs Net										0
24											
25	Total Operating Expenses	0	(794)	(3,856)	0	0	0	0	0	0	(4,650)
26											
27											
28	NET OPERATING INCOME	\$0	\$794	\$3,856	\$0	\$0	\$0	\$0	\$0	\$0	\$4,650

Consumers Illinois Water Company - Candlewick Sewer District
Statement of Operating Income with Adjustments
For the Test Year Ending December 31, 1994

Line No	Description	Company Rebuttal Pro Forma Present	HEPO Adjustments (Sch 2)	HEPO Pro Forma Present (Cols. B+C)	Company Proposed Increase	Proposed Rates with HEPO Adjustments (Cols. D+E)	Adjustment To Proposed Increase	HEPO Pro Forma Proposed (Col. F+G)	Revenue Change (Col H-D)	% Revenue Change (2)
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)
1	Tariffed Revenues	\$539,628	\$0	\$539,628	\$679,990	\$1,219,618	(\$7,867)	\$1,211,751		
2	Other Revenues	13,511	0	13,511	17,007	30,518	(\$197)	30,321		
3										
4	Total Operating Revenue	553,139	0	553,139	696,997	1,250,136	(8,064)	1,242,072	\$688,933	124.55%
5										
6	Salaries and Wages	102,530	(1,296)	101,234		101,234		101,234		
7	Employee Pensions and Benefits	12,325	0	12,325		12,325		12,325		
8	Purchased Power	76,815	0	76,815		76,815		76,815		
9	Chemicals	2,979	0	2,979		2,979		2,979		
10	Materials and Supplies	13,060	0	13,060		13,060		13,060		
11	Other Oper. and Maintenance Exp.	54,414	0	54,414		54,414		54,414		
12	Regulatory Commission Expense	39,857	(6,294)	33,563		33,563		33,563		
13	Bad Debts	3,016	0	3,016	783	3,799	(70)	3,729		
14	Depreciation Expense	172,630	0	172,630		172,630		172,630		
15	Taxes other than Income	105,014	0	105,014		105,014		105,014		
16										
17	Total Operating Expense									
18	Before Income Taxes	582,640	(7,590)	575,050	783	575,833	(70)	575,763		
19										
20	State Income Tax	(20,368)	545	(19,823)	49,988	30,165	(574)	29,591		
21	Federal Income Tax	(91,857)	2,395	(89,462)	219,721	130,259	(2,523)	127,736		
22	Deferred Taxes and ITCs Net		0	0		0		0		
23										
24	Total Operating Expenses	470,415	(4,650)	465,765	270,492	736,257	(3,167)	733,090		
25										
26										
27	NET OPERATING INCOME	\$82,724	\$4,650	\$87,374	\$426,505	\$513,879	(\$4,897)	\$508,982		
28										
29										
30	HEPO Rate Base							\$5,408,949		
31										
32	HEPO Overall Rate of Return							9.41% (1)		

(1) Source: Staff EX 4.00, Schedule 18.

(2) Source: Column (I), Line 4, divided by Column (D), Line 4.

Consumers Illinois Water Company - Woodhaven Water District
Adjustments to Rate Base
For the Test Year Ending December 31, 1994

[illegible]

Consumers Illinois Water Company - Woodhaven Water District
Rate Base
For the Test Year Ending December 31, 1994

Line No	Description	Company Rebuttal Pro Forma	HEPO Adjustments (Sch. 2)	HEPO Pro Forma (Col B+C)
	(A)	(B)	(C)	(D)
1	Plant in Service	\$3,442,646	\$0	\$3,442,646
2	Depreciation Reserve	(972,384)	0	(972,384)
3				
4	Net Plant	2,470,262	0	2,470,262
5				
6	Additions to Rate Base:			
7				
8	Materials and Supplies	13,178	0	13,178
9	Working Capital	30,497	(426)	30,071
10	Accum. Amortization of Contrib.			
11	in Aid of Construction	287,022	0	287,022
12				
13				
14				
15				
16	Deductions from Rate Base:			
17				
18	Contributions in Aid			
19	of Construction	(916,846)	0	(916,846)
20	Deferred Income Taxes	(193,776)	0	(193,776)
21	Post-retirement Benefits	(646)	0	(646)
22				
23				
24				
25				
26				
27				
28				
29	HEPO Rate Base	\$1,689,691	(\$426)	\$1,689,265

Consumers Illinois Water Company - Woodhaven Water District
Adjustments to Operating Income
For the Test Year Ending December 31, 1994

Line No	Description	Interest Synchron-ization (Staff EX 1.00R, Sch.6R)	Incentive Compensation (Staff EX 3.00R, Sch.1R)	Rate Case Expense (Staff EX 3.00R, Sch.2R)	(E)	(F)	(G)	(H)	(I)	(J)	Total Operating Statement Adjustments (K)
	(A)	(B)	(C)	(D)							
1	Tariffed Revenues										\$0
2	Other Revenues										0
3											
4	Total Operating Revenue	0	0	0	0	0	0	0	0	0	0
5											
6	Salaries and Wages		(3,407)								(3,407)
7	Employee Pensions and Benefits										0
8	Purchased Power										0
9	Chemicals										0
10	Materials and Supplies										0
11	Other Oper. and Maintenance Exp.										0
12	Regulatory Commission Expense			(474)							(474)
13	Bad Debts										0
14	Depreciation Expense										0
15	Taxes other than Income										0
16											
17											
18	Total Operating Expense										
19	Before Income Taxes	0	(3,407)	(474)	0	0	0	0	0	0	(3,881)
20											
21	State Income Tax	1	245	34	0	0	0	0	0	0	280
22	Federal Income Tax	6	1,075	150	0	0	0	0	0	0	1,231
23	Deferred Taxes and ITCs Net										0
24											
25	Total Operating Expenses	7	(2,087)	(290)	0	0	0	0	0	0	(2,370)
26											
27											
28	NET OPERATING INCOME	(\$7)	\$2,087	\$290	\$0	\$0	\$0	\$0	\$0	\$0	\$2,370

Consumers Illinois Water Company - Woodhaven Water District
Statement of Operating Income with Adjustments
For the Test Year Ending December 31, 1994

Line No	Description	Company Rebuttal Pro Forma Present	HEPO Adjustments (Sch 2)	HEPO Pro Forma Present (Cols. B+C)	Adjusted Company Proposed Settlement Increase (1)	Proposed Rates with HEPO Adjustments (Cols. D+E)	Adjustment To Proposed Increase	HEPO Pro Forma (Cols. G+H)	Revenue Change (Col I-D)	% Revenue Change (2)
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)
1	Tariffed Revenues	\$437,317	\$0	\$437,317	\$43,366	\$480,683	\$33,212	\$513,895		
2	Other Revenues	29,506	0	29,506	2,682	32,188	\$2,224	34,412		
3										
4	Total Operating Revenue	466,823	0	466,823	46,048	512,871	35,436	548,307	\$81,484	17.46%
5										
6	Salaries and Wages	83,211	(3,407)	79,804		79,804 ✓		79,804		(3)
7	Employee Pensions and Benefits	40,038	0	40,038		40,038 ✓		40,038		
8	Purchased Power	34,597	0	34,597		34,597 ✓		34,597		
9	Chemicals	4,348	0	4,348		4,348 ✓		4,348		
10	Materials and Supplies	7,698	0	7,698		7,698 ✓		7,698		
11	Other Oper. and Maintenance Exp.	55,405	0	55,405		55,405		55,405		
12	Regulatory Commission Expense	3,000	(474)	2,526		2,526 ✓		2,526		
13	Bad Debts	36,322	0	36,322	3,583	39,905	2,757	42,662		
14	Depreciation Expense	43,762	0	43,762		43,762		43,762		
15	Taxes other than Income	28,923	0	28,923		28,923		28,923		
16										
17	Total Operating Expense									
18	Before Income Taxes	337,304	(3,881)	333,423	3,583	337,006	2,757	339,763		
19										
20	State Income Tax	3,627	280	3,907	3,049	6,956	2,346	9,302		
21	Federal Income Tax	15,337	1,231	16,568	13,401	29,969	10,313	40,282		
22	Deferred Taxes and ITCs Net	0	0	0		0		0		
23										
24	Total Operating Expenses	356,268	(2,370)	353,898	20,033	373,931	15,416	389,347		
25										
26										
27	NET OPERATING INCOME	\$110,555	\$2,370	\$112,925	\$26,015	\$138,940	\$20,020	\$158,960		
28										
29										
30	HEPO Rate Base							\$1,689,265	(1)	
31										
32	HEPO Overall Rate of Return							9.41%	(2)	

(1) Source: ICC Staff EX 1.00, Schedule 1, C, Column (E).

(2) Source: Column (J), Line 4, divided by Column (D), Line 4.

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

CERTIFICATE

Re: 95-0641

I, DONNA M. CATON, do hereby certify that I am Chief Clerk of the Illinois Commerce Commission of the State of Illinois and keeper of the records and seal of said Commission with respect to all matters except those governed by Chapters 18a and 18c of The Illinois Vehicle Code.

I further certify that the above and foregoing is a true, correct and complete copy of order made and entered of record by said Commission on October 23, 1996.

Given under my hand and seal of said Illinois Commerce Commission at Springfield, Illinois, on October 25, 1996.

Donna M. Caton